SGI Sustainable Governance Indicators

2015 Economy Report

Economic Policy

Bertelsmann Stiftung

Indicator

Economic Policy

Question

How successful has economic policy been in providing a reliable economic framework and in fostering international competitiveness?

41 OECD and EU countries are sorted according to their performance on a scale from 10 (best) to 1 (lowest). This scale is tied to four qualitative evaluation levels.

10-9 = Economic policy fully succeeds in providing a coherent set-up of different institutional spheres and regimes, thus stabilizing the economic environment. It largely contributes to the objectives of fostering acountry's competitive capabilities and attractiveness as an economic location.

8-6 = Economic policy largely provides a reliable economic environment and supports the objectives of fostering a country's competitive capabilities and attractiveness as an economic location.

5-3 = Economic policy somewhat contributes to providing a reliable economic environment and helps to a certain degree in fostering a country's competitive capabilities and attractiveness as an economic location.

2-1 = Economic policy mainly acts in discretionary ways essentially destabilizing the economic environment. There is little coordination in the set-up of economic policy institutions. Economic policy generally fails in fostering a country's competitive capabilities and attractiveness as an economic location.

Denmark

Score 9

Prior to the global financial crisis, the Danish economy experienced a boom period. Unemployment reached record lows, there was a current account surplus and the public budget was in the black. However, there were also clear signs of an overheating economy driven by booming domestic demand. The housing market experienced very strong price increases, in part driven by financial liberalizations and the so-called tax freeze, which put a limit on property taxation (ejendomsværdiskatten). The high employment rate resulted in wage increases and, since productivity growth fell below competitors' levels, wage competitiveness deteriorated significantly over the period up to the financial crisis. Structural problems were growing, but the country's favorable account balance and the surpluses on public budgets concealed the problems.

The global financial crisis significantly affected the Danish economy. GDP decreased by about 1% in 2008 and by 5.7% in 2009. Although average growth has been positive since 2009, the growth rate has been modest and thus insufficient to produce a major employment increase; growth in 2013 was -0.5%. The government and the Economic Council predict a growth rate close to 0.5% in 2014. In October 2014, the Economic Council predicted 1.5% growth for 2015 and 2.5% for 2016. Hence, the recovery has been delayed and is expected to come only slowly. Registered unemployment more than doubled during the crisis (gross unemployment increased from 2% to about 6%), but this concealed a much larger drop in employment. Roughly, the decrease in employment was twice the increase in unemployment. The difference is explained by a significant drop in the labor force, which is due to large inflows into education, increase in activation, as well as to the number of recipients of social assistance not ready for work. Moreover, there may be some hidden unemployment since the registered unemployment rate only includes the unemployed entitled to benefits or social assistance. Unemployment insurance is voluntary, implying that some unemployed are not eligible for unemployment benefits, and at the same time a shortening of the benefit period (from four to two years) has been a major issue. Since social assistance is being means tested on a family basis, expiring unemployment benefits may imply a loss of income support. Various ad-hoc measures have been taken to minimize the consequences of this "drop out problem." According to the latest economic reports, employment is now increasing (almost 20,000 persons over the previous year). The Economic Council does not expect the unemployment rate to decline significantly in 2015.

Public finances changed from large surpluses to deficits as a consequence of the crisis. The large change was a consequence of the sharp decline in GDP and the rather strong automatic budget response (automatic stabilizers). As a consequence, Denmark was violating the 3% budget norm outlined in the Stability and Growth Pact, and it accordingly entered the excessive deficit procedure. The EU recommended that, over the period 2010 to 2013, Denmark bring the deficit below the 3% norm and improve the structural budget by 1.5 percentage points relative to GDP. Denmark succeeded in lowering the deficit substantially in 2013 to -1.1% of GDP and for 2014 a surplus of 1.8% of GDP is expected. This is primarily due to a forward shifting of tax revenue from pensions (so-called capital pensions), deficits are expected for 2015 and 2016. In addition, there is now a criterion (i.e. a fiscal compact) that does not allow the structural budget balance to display a deficit in excess of 0.5% of GDP. According to Economic Council forecasts, the structural balance would be close to but not violate this target. Fiscal policy plans aim for structural balance in 2020 with a small budget surplus.

The policy agenda (regeringsgrundlag) of the Social Democratic led government that came to power in October 2011 put high priority on kick-starting the economy by strengthening competitiveness and reforming the tax code to reduce tax on earned income. Economic parameters have also affected other reforms adopted under the new government, including reforms of social assistance and study grants. These reforms aim at getting unemployed to look for jobs and students to get through their studies faster. In April 2013, a growth pact was adopted with broad support in parliament.

Citation:
Danish Economic Councils, The Danish Economy, Various issues. Latest issue: Autumn 2014 report, English summary available at:

http://dors.dk/graphics/SynkronLibrary/Publikationer/Rapporter/Efter%E5r%202014/Trykte%20rapport/E14_English_Summary.pdf

Ministry of Economic Affairs and the Interior, Økonomisk Redegørelse, various issues. Latest issue December 2014. Available at http://english.oim.dk/

OECD, Economic Surveys. Denmark. January 2014 http://www.oecd.org/eco/surveys/Overview_Denmark_2014.pdf (accessed 16 October 2014).

Regeringen, Et Danmark der står sammen. Regeringsgrundlag. October 2011. http://www.stm.dk/publikationer/Et_Danmark_der_staar_sammen_11/Regeringsgrundlag_okt_2011.pdf

European Commission, European Economic Forecast Spring 2014. http://ec.europa.eu/economy_finance/publications/european_economy/2014/pdf/ee3_en.pdf (accessed 16 October 2014).

Switzerland

Score 9

The Swiss economic policy regime combines a variety of elements. The common denominator is the practice of muddling through as standard operational procedure and heterodoxy as the primary philosophy underlying economic policymaking. For example, it is a very liberal regime with regard to the regulation of the labor market, in particular to hiring and firing. The rules in this area are very close to those of the United States. By contrast, it was in the past a very illiberal and politicized regime with regard to the in- and outflow of foreign labor. The country's economic policy regime is based on the integration of employers and trade unions into the policymaking process, with employers having the largest amount of influence ("liberal corporatism") and trade unions serving as junior partners. For trade unions, this corporatism has made sense, since it resulted in a regime of full employment (at least for Swiss citizens), high wages and generous private social policy implemented on the firm level. In addition, public-sector social policy has been expanded in terms of programs and expenditure levels.

Throughout the 20th century, Switzerland maintained a very protectionist policy regime, allowing for cartels and the exclusion of competition. The main beneficiaries were farmers, who were protected from world market competition by high tariffs and strict non-tariff barriers, as well as small and medium-sized businesses and service providers producing for the domestic market. Furthermore, collusive pricing was tolerated, while competition between providers and producers was limited by the variance in cantonal regulations. This latter aspect made it very difficult for businesses to make competitive offers and win bids outside their home cantons. The former policy of protectionism has changed considerably since the mid-2000s due to a deliberate strategy of market liberalization. This seemed to come to a halt in the period under consideration, however. For example, an amendment to the law on cartels failed, since it would have reduced the influence of the primary economic interest organizations within the competition agency's governing board. Likewise, parliament passed a law on "Swissness" in 2013, which established rules on whether a product may be labeled "Swiss made." Some rules expected to be implemented as a result would benefit strongly domestic producers, in particular farmers.

Economists have attributed the Swiss economy's strong growth since about 2005 to some of its liberalizing reforms. Others point to the fact that most of the increase in domestic product is not due to higher productivity (GDP per capita), but rather to the increasing volume of hours worked, which itself is at least partially a result of population growth (1% per year, mostly due to immigration).

The government levies low taxes on both labor and capital, producing relatively small tax wedges. In return, this liberal state does not make significant interventions into the business cycle. Rather, it used to pursue a prudent and basically pro-cyclical fiscal policy. In times of major economic problems, such as in 2008 and 2009, fiscal stimulation packages have been implemented. However, for institutional and political reasons, these packages have typically been very limited in size. In addition, it proved difficult to implement these packages swiftly. In fact, many of the resources contained in these fiscal programs have not been taken up by employers.

Industrial policy as a means of actively influencing industrial structure has been eschewed by the Swiss government. Rather, the government has restricted itself to facilitating the modernization of industries by creating favorable conditions for economic activity. In the financial field, Switzerland has improved its surveillance of banks and has set high standards for prudential banking regulations since the onset of the "great recession" in 2008.

The country's policymakers have long placed particular emphasis on maintaining a prudent fiscal policy (low deficit and debt levels) and price stability. This prudence has resulted from a combination of institutional factors, in particular the fiscal weakness of the federal state compared to the cantons, rules limiting excessive deficits and debts (for example, a so-called debt brake), and the effects of direct democracy. Citizens have typically been reluctant to accept any policy changes that might imply an increase in taxation. These institutional factors have been further reinforced by the distribution of political power, in particular by the weakness of the political left, and the presence of a strong party (the Free Democrats, which are in this respect liberal) that supports a constrained tax state. Responsibility for price stability is left to the independent National Bank, which is tasked with maintaining price stability as a primary goal, and has the tools of monetary and interest-rate policy at its disposal.

In general, decision-makers have pursued a very pragmatic and heterodox economic policy, and have shown themselves willing to disregard liberal norms of policymaking if the need arises. For example, in recent years the Swiss government and the Swiss National Bank intervened massively to prevent the bankruptcies of Swiss International Air Lines, the national airline, and UBS, one of the country's two major banks. The support of the UBS turned out in the end to be a success for taxpayers.

This policy regime, which has been both liberal and protectionist, has come under pressure due to various changes in the economic environment. For one, deindustrialization and a marked shift to a service economy has meant a change in the demand for labor. The industrial sector once offered a large number of jobs with low skill requirements. These jobs were staffed to a disproportional extent by foreign labor. Due to the rules of the work permit system, many foreign workers gained access to unlimited work permits between the mid-1970s and the mid-1990s. However, given their low skill levels, there is not enough demand for these employees in the modern high-skill service sector. Hence, the unemployment curve has shifted upward, and is today characterized by high rates of unemployment among foreign workers with low skills.

At the same time, employers are recruiting increasingly highly skilled labor for the service sector. It is true that Switzerland has depended on the inflow of highly skilled employees for the last century, but this process has further intensified during the last 20 years, when the proportion of highly skilled employees among immigrant workers rose from 16% to 56%. One result has been a pronounced increase in social tensions. Historically, the highly educated Swiss middle classes have been very much in favor of a pro-foreigner policy, as long as these foreigners did not offer major competition for this social sector’s jobs and housing opportunities. With the increasing inflow of highly skilled German labor, this tolerance has eroded. This is also one of the reasons for the success of the popular initiative imposing a cap on migration.

Globalization has also led to the increasing importance of international organizations such as the WTO. Given its reliance on sectors such as chemicals and machine production, banking and tourism, Switzerland has had no option but to accept the liberalization of trade and services. Moreover, liberalization was accelerated by the bilateral treaties with the European Union. Even beyond these treaties, practically all new economic law has followed EU standards. As a consequence of globalization and Europeanization, most sectors once strongly shielded by protectionist policies have become liberalized. Agriculture offers a major case in point. As a result of this liberalization from outside, the previous complementarity between protected domestic industries and a world-market-oriented industry – the driver of Switzerland’s post-war economic successes – has become strained. The potential increase in tensions between the export and domestic sectors has not resulted in open conflict, with the exception of some minor actions at the beginning of the liberalization period. Yet these developments have increasingly undermined the country’s system of interest representation and the corporatist structure of interest intermediation. Interest organizations, in particular employers’ groups, have lost support, while their members have increasingly turned to lobbying on an individual-firm basis.

On a related note, Switzerland has not yet solved the question of its long-term relationship with the European Union. In the 2013 – 2014 period, the quest for politically and economically sustainable solutions became more pressing. Previous solutions have entailed bilateral agreements between the European Union and Switzerland, which have had major implications for the further liberalization of the service and agriculture sectors. In addition, immigration policy has changed substantially. Switzerland has abstained from any further recruitment of foreign labor from non-EU countries (for which there is little demand anyway), and has instead liberalized the immigration regime with EU countries. Essentially, this has meant free movement of labor between Switzerland and the European Union, intensifying the new problems and cleavages associated with the recruitment of highly skilled employees from abroad. However, this bilateral strategy today faces major problems. The European Union has requested new institutional solutions to complement and reinvigorate the bilateral relationship. It argues that the implementation and update of bilateral agreements has become too costly in terms of time and internal conflict. Specifically, the EU has insisted on the creation of independent institutions for the settlement of disputes on the basis of the bilateral agreements, as well as mechanisms for updating bilateral agreements without having to resort to new full-scale negotiations. As of the fall of 2014, no new institutional solutions had yet been found. This calls the future relationship between Switzerland and the European Union into question. Given the country's close integration with the EU market – 60% of Swiss exports go to the European Union, and 80% of its imports come from the EU – Switzerland is highly dependent on a functional working relationship with this much larger economic partner. By contrast, the EU is much less dependent on Switzerland.

In February 2014, problems in this area were further intensified when the Swiss people passed a ballot initiative against mass immigration. The measure introduced a new article into the constitution that establishes a cap on immigration whenever this is required by the economic interests of Switzerland. Any international treaty that is not compatible with this rule has to be renegotiated or terminated within three years. This implies either that the treaty between Switzerland and the European Union on the free movement of labor needs to be renegotiated, or that Switzerland will effectively deliberately violate it. However, shortly after the initiative's passage, the EU signaled that it was not willing to enter negotiations on this issue. This is a major challenge for the Swiss economy and economic policy, since it endangers the inflow of the (highly skilled) labor from the European Union on which the Swiss economy depends. Since the treaty on the free movement of labor is also connected to a number of other important bilateral treaties – if one treaty is terminated, the other treaties are also terminated automatically – this represents a major threat to economic exchange between Switzerland and neighboring EU nations.

Switzerland was a laggard in the development of the welfare state, though it caught up in the post-war period. Today it has a mature and generous liberal-conservative welfare state. In times of demographic change, this welfare state is only sustainable through high rates of economic growth. It is far from clear whether these high rates of growth can be realized in the future, in particular if the inflow of foreign labor from and trade with the EU is negatively affected by the implementation of the constitutional article on mass immigration.

Canada

Score 8

Canada has implemented market-oriented economic policies that have enhanced the country's competitiveness and attractiveness as a location to do business. Yet these policies appear not to have had a positive impact on productivity growth, which has been very weak. There are still areas where Canada's economic framework is not as conducive as it might be to productivity growth. The most egregious of these is the continued presence of marketing boards, which have the right to control output through production quotas. Interprovincial barriers to trade and labor mobility, and the lack of a national securities regulator are other weaknesses in Canada's regulatory framework from a competitiveness perspective. In the 2014 federal budget, the federal government continued its ongoing austerity campaign by reducing direct program spending by roughly 5%, determined to balance the budget by 2015. In light of the relatively weak international economic climate and the prevailing low interest rates, the potentially negative macroeconomic impacts of a contractionary fiscal policy drew some criticism.

Citation:
2014 Federal Budget "The Road to Balance, Creating Jobs and Opportunities", posted at posted at http://www.budget.gc.ca/2014/docs/plan/pdf/budget2014-eng.pdf

Chile

Score 8

Chile has an advanced macroeconomic and financial policy regime in place. This is rules-based and combines a floating exchange rate, inflation targeting, an autonomous central bank, an overall government budget rule, and effective regulation and supervision of banks and capital markets. As a result, macroeconomic performance has generally been quite satisfactory. A dominant economic role is assigned to external trade, markets and the private sector, complemented by active government regulation and policies aimed at limiting noncompetitive market conditions, extending social protection, and to a limited degree reducing poverty and income concentration. Economic legislation and regulations provide a level playing field for domestic and foreign competitors. Barriers to international trade and capital flows are negligible, and international competitiveness, adjusted for labor productivity, is relatively high. These policies have enabled a relatively high level of growth, and poverty rates have fallen substantially in the last few decades. During the last two years, economic growth has again increased and unemployment slightly decreased.

On the other hand, major structural weaknesses can be observed. Low labor efficiency represents an increasing problem. This is especially the case in small- and middle-scale businesses which are the largest source of employment and labor in Chile. The highly bureaucratic public administration is another negative aspect that limits productivity. Moreover, economic stability and growth almost completely depend on the export of commodities such as copper and agri- and silvicultural products with relatively low added value. Thus, Chile shows a low level of industrialization; the manufacturing sector is small and the majority of consumer, intermediate and capital goods have to be imported. Chile is also highly dependent on energy imports. Minor education-sector reforms have focused primarily on higher education, but given Chile's economic structure, there is a strong need to enhance capacities at a technical level. In the long run, deficiencies in the education system along with low investment rates in infrastructure and R&D will probably hinder economic growth and undermine the sustainability of the country's development path.

Estonia

Score 8

As an EU member state, Estonia forms its economic policy in accordance with EU strategies. Thus, the ideology of smart growth has been the guiding principle of national economic policy. Estonia used to have seven-year strategies for entrepreneurship policies; however, a strategy for the 2014 – 2020 period was approved by the government in September 2013. Elaboration of economic and innovation policy is the responsibility of the Ministry of Economic Affairs and Communications. In parallel, the Ministry of Education and Research develops and coordinates implementation of the national R&D strategy.

These two strategies are supposed to be complementary. However, poor coordination, duplication and lack of synergy between ministries have been continuous problems. A clear example of lacking coordination is the issue of labor policy. The Ministry of Economic Affairs analyses the current and perspective need for labor, Ministry of Education implements initial and in-service training policy, and the Ministry of Social Affairs is responsible for employment policy. Additionally, since there is a lack of highly qualified workers, the Ministry of Interior, which is responsible for immigration issues, also becomes an important actor in economic policy. Besides a lack of coordination between ministries, a shortage of qualified and motivated workers is another barrier in building a smart economy.

The government supports enterprises through efforts to enhance their export capacities, mainly via Enterprise Estonia (EE), an organizations that provides financial assistance, counseling, cooperation opportunities and training for entrepreneurs. However, this body has been widely criticized for having too little impact on economic growth; in May 2014, this led to changes in the membership of its management board and supervisory board. The new CEO of the EE, the Auditor General, and some individual members of parliament have voiced dissatisfaction with country's recent economic development path, noting that growth rates have not met expectations, efforts to pass tax reform have been stalemated, and that the country is losing attractiveness for foreign investors and highly skilled workers.

Estonia ranks just above the 100th position internationally in terms of its ability to attract and keep highly skilled workers. In efforts to respond to these concerns, the government has prepared amendments to the Aliens Act making it easier to issue residence and work permits to highly skilled workers. At the end of 2014, a digital residency program was launched, giving foreigners access to all Estonia's e-services, including the use of a digital signature.

Germany

Score 8

Over the last 10 years, Germany's economic policy has successfully addressed numerous serious economic weaknesses prevalent in the post-unification period. For comparison, Germany's economic structure is characterized by a healthy mix of service and industrial sectors (cf. Statistische Bundesamt). A wave of reforms, affecting labor market institutions, unemployment benefits, the pension system, corporate taxation, the constitutional debt brake and the liberalization of labor migration from outside the EU, have improved Germany's competitiveness and increased its attractiveness as an destination for cross-border investment. This trend was recently boosted by uncertainties arising from sovereign debt crises in other European countries. Moreover, trade unions and employers' associations have eschewed ideology in setting wage policy, granting firms significant flexibility. Over the last decade, productivity has increased and unit labor costs have largely remained stable, in contrast to significant increases in many other European countries. However, Germany's recent robust economic performance and the buoyant labor market have triggered the end of an era of restraint. There is a marked trend of rising wages, along with a slight increase in unit labor costs – a development which so far has not deteriorated export performance and aligns with external requests to stimulate domestic demand in order to shrink the large current account surplus.

The positive labor market developments contrast with Germany's very modest growth potential, which the German Council of Economic Experts quantifies at only 1.0 to 1.1%. Actual growth rates were below 1% in 2012 and 2013. With regard to major indicators of economic performance the picture is also mixed. Employment rates have risen continuously and reached an all-time high of more than 42 million persons employed. Unemployment rates are at their lowest level in 20 years. However, rates of unemployment have not altered significantly since 2011, signifying that without further reforms the lower bound has been reached. In addition, the tax system still creates labor market disincentives for second earners in a family. There is also a significant share of temporary work, though the share of "atypical jobs" did not increase between 2005 and 2013 and is below the OECD average (Sachverständigenrat, 2014: 283). To address the problem of the working poor, a general minimum wage was introduced, but this policy remains heavily debated with respect to the risk of job losses for workers with low qualifications.

Regarding financing public services, Germany's ability to refinance its debt on international capital markets has never been better. It seems, however, that this period of easy money may come to an end. The inward flow of foreign direct investment reached its peak in 2011 and 2012, and fell back to normal levels in 2013. According to UNCTAD’s World Investment Report 2014, Germany ranked fifth among EU countries (billion) in 2013.

Despite some imperfections, within a broader time frame Germany’s economic policy has clearly been successful in making its economy a highly attractive location for investment. Even though the German government’s willingness to reform has dramatically declined since 2008, global investors perceive the country as an economic safe haven.

Citation:
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Forecast growth
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Employment rate
http://de.statista.com/statistik/daten/studie/1376/umfrage/anzahl-der-erwerbstaetigen-mit-wohnort-in-deutschland/

Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung (2014): Mehr Vertrauen in Marktprozesse, Jahresgutachten 14/15, Sachverständigenrat: Wiesbaden.

Latvia

Score 8

Latvia met its long-standing economic policy goal of joining the eurozone on 1 January 2014. At the time, its economic growth rate of 4.1% was the highest in Europe. Following a difficult period of economic adjustment and after fulfilling its ambitious fiscal consolidation targets, Latvia’s economy rebounded, returning to the international markets and to favorable economic growth rates. The heavy oversubscription of a seven year government bond, which was issued in January 2014 and priced at €1 billion, signaled the high level of confidence in the economy.

Latvia’s economic policy had been governed by parameters accepted as part of financial assistance provided by the IMF and EU. As this assistance has since been repaid, these parameters have been withdrawn. While these parameters led the economy into a difficult period of adjustment, they provided a framework in which the economy established fiscal discipline. For example, in 2013, Latvia introduced legislation that placed a cap on the public budget deficit and launched a multi-year planning cycle.

Unemployment rates have fallen from 16.2% in 2011 to 11.9% in 2013 and have continued to fall through 2014 (as indicated by the Central Statistical Bureau). However, structural unemployment remains a challenge.

The government has focused strongly on meeting euro accession criteria. Nevertheless, structural reforms are also ongoing in the areas of education and science, the energy market and the judicial system, among others. These reforms are key to the future economic competitiveness of Latvia. Yet, the government's commitment and ability to implement these reforms is weaker than for euro-related policies. Significant parliamentary and stakeholder resistance has delayed reforms to the higher education system and the opening of the energy market to competition, for example.

Citation:
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2. Central Statistical Bureau (2012), Growth Rate Indicators, Available at: http://www.csb.gov.lv/en/real-gdp-growth-rate, Last assessed: 20.05.2013.

3. Central Statistical Bureau (2013), "Employment is still growing", Update, Available at:

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4. IMF (2014), Article IV Consultation Report, Available at:

http://www.imf.org/external/pubs/ft/scr/2014/cr14115.pdf, Last Assessed: 02.11.2014

5. European Commission (2013), EU BOP Assistance to Latvia - Second Review Under Post - Programme Surveillance, Available at:

http://ec.europa.eu/economy_finance/eu_borrower/balance_of_payments/pdf/lv_efc_note_2nd_pps_mission_en.pdf, Last assessed: 21.05.2013.

Lithuania

Score 8

Lithuania's economic policies have created a reliable economic environment, fostering the country's competitive capabilities and improving its attractiveness as an economic location. At the end of 2014, the World Bank ranked Lithuania 24th worldwide in terms of ease of doing business. The individual attributes of registering property (9th place), starting a business (11th place), enforcing contracts (14th place) and dealing with construction permits (48th place) were assessed the most positively, whereas those of protecting investors (78th place) and access to electricity (105th place) received the lowest rating. It should be noted that labor-relations regulations were not assessed in this edition of the survey. On this indicator, Lithuania used to be ranked relatively low, and the government has as yet undertaken no major reforms enhancing the flexibility of the labor market. The country was also ranked 41st in the World Economic Forum's 2014 – 2015 Global Competitiveness Report, with some factors such as higher education and training (ranked 26th worldwide) scoring above its overall average, and some factors such as market size (77th place worldwide) falling significantly below.

The European Commission identified the following challenges to Lithuania's long-term competitiveness: unfavorable demographic developments, labor market deficiencies and high emigration rates, growing levels of poverty and social exclusion, a lack of competition and interconnections in the country's infrastructure (particularly its energy system), low energy efficiency (especially in the case of buildings), a low level of R&D spending, and poor performance with respect to innovation. A new economic challenge has arisen from Russia's ban on some imports from the European Union. This has disproportionately affected Lithuania, as its ratio of food exports to Russia to GDP was the highest in the EU. It has been estimated that Russia's current embargo on food imports will reduce Lithuania's GDP by 0.8%.

Although the 2008 – 2012 Lithuanian government stabilized Lithuania's economy and public finances through substantial fiscal consolidation, other reform efforts have been more limited, in particular those relating to the labor market, social policies, energy efficiency and the energy sector. However, the government formed after the 2012 parliamentary elections continued and completed some of its predecessor's projects. Construction of the new liquefied-natural-gas terminal (LNG) was finished in December 2014, for example, and another important project establishing electric-power transmission connections with Sweden is expected to be completed by the end of 2015. These projects are expected to provide alternative energy-supply sources, and have received significant attention. If an appropriate regulatory environment is created allowing good trade relations in the natural-gas and electricity sectors, the completion of these projects should also contribute to cheaper energy prices and more competitive business conditions in Lithuania.

Considerable political emphasis has been placed on structural reforms, especially in the previous government's program, but a significant number of these have been left unimplemented. Streamlining the regulatory environment for businesses is one of the few areas where progress has been achieved. As the economy recovered, with Lithuania becoming in recent years one of the fastest-growing economies in the European Union, the political will to reform has decreased, especially in fields such as the pension system or health care. More progress has been made in recent years on the renovation of apartment blocks, which contributes to improving the energy efficiency of housing.

Citation:
COMMISSION STAFF WORKING DOCUMENT on the assessment of the 2014 national reform program and convergence program for Lithuania: http://ec.europa.eu/europe2020/pdf/csr2014/swd2014_lithuania_en.pdf.
See the 2014-2015 Global Competitiveness Report of the World Economic Forum: http://www.weforum.org/reports/global-competitiveness-report-2014-2015

Malta

Score 8

Economic planning is at the forefront of Malta's policymaking prowess and a clear-cut assignment of tasks to government institutions is its strength. There are important ties between public institutions as well as between the economic planning ministry and social partners. The government retains final decision-making powers; however, consultation with social partners through the Malta Council for Economic and Social Development occurs regularly, in which council, budgetary, labor and fiscal policies are agreed upon. Because of these strong ties, Malta managed to weather the global economic crisis better than most other EU member states. This is corroborated by the European Economic Forecast, which highlights the fact that Malta's labor market is resilient and boasts one of the lowest unemployment rates in the euro area. Current industrial legislation provides protection against dismissals and allows for open bargaining between employers and their unions, but offers little in the way of co-determination.

Since EU membership in 2004, Malta has also strengthened its regulatory institutions, entrenching efficient anti-monopoly policies, while membership in the euro zone has forced it to further expand its economic planning capacity.

A 2012 World Bank Report reviewing the ease of doing business ranked Malta 167th worldwide, citing long delays in obtaining construction permits and electricity services. Local businesses also cited the high cost of electricity in eroding their competitive edge. The government has announced measures to cut red tape, and promised lower tariffs for businesses as a part of the 2015 budget. The 2014 Global Competitiveness Index highlighted improvements in the country's macroeconomic climate, spotlighting the government's balancing of the budget, an increase in gross national saving and a downward trend in inflation. However, the report indicated that Malta ranked poorly with regard to the number of procedures necessary to start a business, as well as the number of days needed to start a business. The 2014 World Bank report also highlighted voluminous regulations that hinder business, though the report registered a slight improvement in this area. In 2014, Malta also registered a rise in its trade deficit. However, the EU Commission's Europe 2020 report on Malta projected strong economic growth for the island

Citation:
European Economic Forecast Winter 2013 p.66
Pre-Budget Document 2014.
vision2015.gov.mt
Global Competitiveness Report 2011- 2012
Sansone, K. Its not Easy Doing Business in Malta Says World Bank. Times of Malta 27/10/12
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Times of Malta Archaic laws to face the chop, COLA to stay, 27/10/2014
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Global Competitive Index 2014
World Bank Report 2014
Sharp Rise in Malta's Trade Deficit as Exports, Imports Decline. Times of Malta 12/05/14

Norway

Score 8

Norway's public finances are solid, the state budget effectively running a massive surplus as a result of vast petroleum revenues from the North Sea as well as healthy budgetary discipline. The country has long enjoyed strong economic growth and near-full employment, and has benefited from a well-functioning system of tripartite cooperation. The country weathered the recent world economic crisis with only modest adverse effects. Petroleum revenues are managed in a way that is seen internationally as exemplary, as they are used domestically with prudence and otherwise invested internationally through a sovereign fund focused on equity, bonds and property assets. The economy is, however, sensitive to fluctuations in petroleum prices and has been affected by a fall in oil prices in the second half of 2014. The currency lost about 25% of its value during 2014, albeit from an unusually high level.

The state wields exceptionally strong influence within the economy. About 40% of the equity on the Oslo stock exchange is under state ownership. Combined with the additional 30% under foreign ownership, this means the remaining indigenous private-capital sector is relatively small. When the state makes its investments, it most often does so on market terms. Economic policy is generally considered to be fair and transparent. Regulatory arrangements are generally seen to be sound, although the Oslo stock exchange is volatile, and has been plagued by rumors of insider trading.

The primary strength of Norway’s economy lies in the public sector, particularly with respect to employment. The strongest areas are petroleum and petroleum-related industries such as maritime activities, as well as fisheries and fish-farming. It is a high-cost economy, both in terms of wages and taxes, and international competitiveness suffers in industries outside the petroleum sector.

Although the country has managed its petroleum wealth responsibly, the economy is strongly petroleum-dependent and entrenched at a high cost level. Some observers are concerned that a lack of competitiveness in the mainland economy might pose a future challenge to maintaining the country’s high standard of living and to expectations for continued high public-service standards. The downside of a petroleum-dominated economy, critics argue, is an economy that lacks entrepreneurship, is weak in terms of conventional industries and has less long-term strength than might be suggested by current favorable indicators. It also makes the economy vulnerable to changes in petroleum prices in world markets.

Poland

Score 8

After years of strong growth, the Polish economy experienced a substantial slowdown in 2012 – 2013, largely caused by the repercussions of the Euro crisis. Aided by fiscal expansion and an accommodating monetary policy, however, economic growth re-accelerated in 2014. Poland’s strong economic performance has been facilitated by a good overall economic framework including low labor costs, a stable and well-functioning financial system, a high degree of continuity in economic policy, and a well-functioning administration by regional standards. In the period under review, the pace of the economic liberalization initiated after the 2010 change in government slowed, and the government's pension reform and suspension of the constitutional debt threshold in 2013 have raised some concerns regarding the reliability of economic policy.

Sweden

Score 8

The international financial press has painted a positive picture of Sweden's economic policy and development in Sweden during the last couple of years, and for good reason. Overall, the Swedish economy has fared comparatively well during the global financial crisis, and Swedish crisis management seems to have been extraordinarily successful.

Sweden has received numerous accolades for its financial management. The Financial Times named former (2006-2014) Finance Minister Anders Borg "Best Finance Minister in Europe," and The Economist has urged the rest of the world to look at the "New Nordic Model" as a leading example of economic policy. International institutions like the OECD and the European Union have likewise praised the Swedish trajectory of economic development and the role of government in securing and fostering that development.

The government has implemented a series of reforms that have provided long-term stability in the economy. Also, and equally important, previous governments have chosen not to alter regulatory frameworks which might jeopardize stability, for instance labor market regulations.

Most economic indicators on Sweden look good. This is particularly the case with international competitiveness. All is not well, however. The National Bank of Sweden, fearing deflatationist tendencies in the economy, lowered its "steering interest rate" to an unprecedented zero percent in late October, 2014. Unemployment also remains comparatively high, at least higher than could be expected from the hitherto Swedish full employment in Europe. There are also fears (as mentioned recently in an IMF report) of an emerging bubble economy in the real estate market.

Perhaps even more troubling, there are now signs on both sides of the political aisle to relax their commitment to the regulatory framework of the public budget and the public economy. The previous non-socialist government downplayed the importance of a surplus goal, a stance which the incoming Social Democratic and Green government after the 2014 election has shared. The argument for doing so is that there are urgent programs that require public funding. Also, by sidestepping a rule saying that the budget should be voted on in its totality, the former opposition (now incumbent) parties during the last election period succeeded in stopping individual items in the government's budget. The current opposition (former government parties) have announced that they intend to do the same when the new public budget is deliberated in the Riksdag. All of this bodes not so well in terms of the long-term prospects of the economic regulatory framework.

Moreover, some sectors of the economy, for example the housing market, suffer from low efficiency and lack of transparency. In addition, the tax reforms the government implemented in the period under review further undermined economic equality. Still, the Swedish economy and Swedish regulation of the economy may be judged as highly competitive and efficient. Whether this record is due to policy incentives, or if it is a consequence of Sweden being not a member of the eurozone, is contested in economic literature.

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United Kingdom

Score 8

The UK economic framework was substantially reformed after 1979 in a market-friendly direction and most of these reforms were maintained after the election of the Labour government in 1997, albeit with some rebalancing towards labor interests – notably through the introduction of a minimum wage. The UK economy grew steadily from the early 1990s up to 2007, but hindsight suggests that the underlying economic model depended too much on consumer demand and on an increasingly risk-prone financial sector. An independent central bank and a golden rule for public finances were supposed to establish macroeconomic stability, but proved to be too easy for the government to manipulate. The resulting high degree of deindustrialization and low level of manufacturing output led to a strong emphasis on the financial sector which contributed substantially both to government revenues, employment, and the country’s balance of payments.

Because of the financial sector’s increased share in the economy, the United Kingdom was badly hit by the financial crisis that began in 2007 and has since been struggling to deal with the aftermath. Taxes on the banking and consumer sectors fell, public expenditure rose and public finances also had to support vulnerable banks.

The change in government in 2010 led to the adoption of an economic policy framework ostensibly focused on budgetary consolidation, but in reality the squeeze on public spending has been less than is often claimed because the government chose to exempt key areas such as health spending. The corollary, especially as the government debt rose, adding to debt service charges, was that cuts in other areas of public spending had to be very deep, and were therefore politically highly contested. Nevertheless, the markets have accepted that the UK economy is on a sustainable trajectory, aided by the very loose monetary policy maintained by the Bank of England.

Despite critical assessments from the likes of the IMF early in 2013, the economic strategy is bearing fruit: GDP growth is projected to be 3.2% in 2014, while the unemployment rate fell below 6.0% in November 2014 and employment has reached an all-time high. However, there are concerns about the rising current-account deficit and about the number of households facing poverty despite the employment of at least one member. The next government will face continuing pressure to rebalance the economy.

United States

Score 8

The United States has maintained economic policies that have effectively promoted international competitiveness and economic growth. Compared with other developed democracies, the United States has had generally low taxes, less regulation, lower levels of unionization, and greater openness to foreign trade. Although its pro-business policies have had costs with respect to social conditions, the country has enjoyed superior growth, capital formation and competitiveness over the past two decades.

Obama’s economic policy was formed in response to the 2008 financial and economic crisis. The administration continued an expansionary fiscal policy to stimulate the economy. Some economists criticized the stimulus package as too small, and in subsequent years, congressional Republicans and some Democrats have effectively blocked further stimulation. However, the Federal Reserve has also held interest rates at historically low levels and reinforced the effect with large-scale bond purchases. As a result, the U.S. economy has been slowly recovering. By the third quarter of 2009, GDP growth turned positive, and job losses stopped in March 2010. Projected growth in 2014 briefly reached a healthy 3% before being revised downward to 1.5%, and the unemployment rate fell below 6%, among the lowest such levels in the OECD.

To prevent a similar crisis in the future, Obama initiated several regulatory reforms (Dodd-Frank Wall Street Reform Act; Consumer Financial Protection Agency). However, as a result of resistance to strong regulatory measures on the part of conservative politicians and the financial industries, Wall Street has resumed some of the practices that increase systemic risk, and which could cause yet another financial collapse. Health care reform has been partly implemented with the aim of controlling health care costs and reducing the federal deficit.

Austerity policies reduced the federal budget deficit to below 3% of GDP in fiscal 2014. However, policymakers have been unable to implement a combination of spending cuts (especially reforms of the middle-class entitlement programs, Medicare and Social Security) and tax increases able to produce declining or even steady budget deficits and stabilization of the federal debt over a 10-year period and beyond. The long-term debt picture has serious implications for monetary stability, and reduces business confidence. U.S. treasury bonds have not regained their AAA rating from the Standard & Poor’s rating agency, although the bond market has not shared the agency’s alarm.

Austria

Score 7

The Austrian economy has remained in good shape despite a difficult European context. A significant part of that success is due to the presence of social partners, which are responsible for negotiating institutional and other reforms, and which thus ensure a comparatively peaceful and cooperative relationship between the country’s various economic players. A substantial part of Austrian economic policy is prepared by the social partners. As in other EU countries, however, an ever-more-significant portion of economic policy falls under the European Union’s jurisdiction, thereby creating an increasingly harmonized European economic framework.

The Austrian export industry has contributed significantly to the country’s overall success. Austria’s economy has profited from the inclusion of former communist East-Central Europe into the European single market. However, Austria’s financial sector in particular suffered significant losses in Eastern Europe during the financial crisis due to its substantial exposure to these markets. The Austrian finance (banks, insurance) and construction industries play an important role in the four Visegrad countries and in most of the former Yugoslav republics.

A process of fiscal consolidation is currently under way, with the goal of keeping the government deficit below 3% of GDP. Other programs include a restructuring of the Austrian banking system to reduce the risk it poses to the national economy. Future burdens may rise from the ever-more-significant redistribution of resources to the generation of people 50 years old and above (to the disadvantage of the younger generations), a trend that clouds the outlook for the young generation and the future of Austria’s economy more generally.

Austria’s rise to become one of the most prosperous countries in Europe, a development with its roots in the early 1950s, is still reflected in its comparatively high rankings in terms of per capita income and employment. However, the country fares less well on rankings of inequality and equality of opportunity; according to a study done by the European Central Bank and published in April 2013, private property in Austria is distributed in an extremely unequal way. The richest 5% of the households in Austria own 37.2% of the overall property in Austria, while the top 50% own 94% of the country’s property. Among the members of the eurozone, only Germany has a more unequal distribution of property.

This seems to contradict the traditional view of Austria as having one of Europe’s most stable social-welfare systems. But these data underline the fact that the Austrian economic success story is not one of increasing equality; indeed, just the opposite is true.

Belgium

Score 7

Over the last years, Belgium has enacted several institutional and economic reforms. The previous federal government was formed at a time when the main fear was that the country may split in two, between Flanders and Wallonia. This concern, combined with the effects of the economic crisis, forced the government to enact the most urgent economic reforms (primarily pension and labor market reforms), but also prevented it from pursuing effective long-term planning. Overall, the country is probably in a better position than it was a few years ago, but the challenges ahead are still numerous. The reforms implemented have been more timid than similar reforms implemented elsewhere in other European countries (UK, Spain, Portugal or, before them, Germany and the Netherlands). Belgium’s competitive edge is slowly eroding.

Much of the political tension in the country stems from financial transfers from the more affluent region of Flanders to the poorer regions of Brussels and Wallonia. In an attempt to alleviate tensions, the government has imposed tough reforms that seek a drastic reduction in such transfers within 10 years. These reforms are designed to incentivize the pursuit of forward-looking reforms. However, little in the way of outcomes has to date been realized.

Finally, some fiscal competences are being devolved from the federal to the regional governments, which may trigger some fiscal competition. The issue is however that fiscal competition risks being intensified in areas that create lots of externalities, making a competitive solution a priori inefficient.

The challenges ahead are enormous: public debt is still at 100% of GDP; together with Italy, tax rates on labor are the highest in the OECD, and there are pockets of high unemployment, mainly in Wallonia and in the Brussels capital region.

Finland

Score 7

The Finnish economy has not recovered to its pre-recession levels of 2008. Preliminary data, available at the time of writing, indicates that Finland has entered its third recession in six years. GDP contracted 0.8% between the third and fourth quarters of 2013. Furthermore, while other Nordic countries are emerging from recession, due to lowered export competitiveness, weakened investment and subdued private consumption, Finland faces continued negative growth and the threat of losing its AAA rating. In fact, the impact of the recession on public finances has been so strong that a full recovery will not achieved for several years.

Fiscal policy is a concern as public debt is growing and as government spending exceeds 50% of GDP. To restore fiscal sustainability, the government is prioritizing greater budgetary prudence and eventually balance. The government is also seeking to raise the minimum statutory retirement age, while improving incentives for people to continue working into later life. The government has is also working toward reform of the system of wage setting. So far efforts and outcomes have been mixed. However, significant reforms of the retirement system, which in September 2014 are in the negotiation phase between the employer and employee interest organizations, must be realized. Otherwise, further fiscal consolidation will soon be needed to manage the increasing costs of Finland’s aging population.

While the Finnish economy continues to be among the world leaders in several measures of economic freedom, the performance of the country has declined. According to the Heritage Foundation 2014 Index of Economic Freedom, Finland’s economy was ranked 19 among the freest economies, a fall from its 2012 rank of 16. In the European region, Finland was ranked nine out of 43 countries in 2014, but seven in 2012. This relative decline can be attributed to the deterioration in fiscal freedom, business freedom and the management of government spending. Still, during the assessment period, the government has maintained monetary stability and encouraged entrepreneurship. Finland remains open to international trade and investment, as its investment regulations are transparent and efficient.

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Ireland

Score 7

On 15 December 2013, Ireland exited the bailout program based on its November 2010 agreement with the EU-ECB-IMF Troika. This was widely hailed as a major achievement that restored a degree of autonomy to national economic policymakers.

Furthermore, the country’s economic-performance indicators turned increasingly positive over the course of 2014. When the minister for finance presented his 2015 budget on 16 October 2014 he was able to claim that considerable progress had been made in restoring the economy to a sustainable growth path, and that the era of (fiscal) austerity was over. Although the debt/GDP ratio remains very high, a primary surplus (that is, excluding interest payments) will be recorded for 2014, and the overall debt burden is expected to decline.

In the course of 2014, international financial markets rapidly revised their view of the Irish economy. Yields on long-term government debt, which peaked at over 12% in mid-2011, fell below 2% toward the end of 2014. Ireland was held up as an exemplar of the successful implementation of an austerity program. Budgetary discipline had reduced the fiscal deficit and restored investor confidence, while wage cuts and labor-market flexibility had improved international competitiveness. Buoyant demand for Irish exports within the United States and United Kingdom contributed to a growing current-account surplus.

The government has consistently fostered a favorable environment for inward investment, particularly through low corporate taxes. A high level of inward investment by multinationals and strong export performance by these firms were important factors in the Irish recovery. However, the role of preferential tax deals with some major foreign investors (notably Apple) attracted increasingly adverse comment among the country's EU partners during 2014, culminating in the EU Commission's announcement that it would investigate the tax deals as being possibly illegal state aid to the company from the Irish government, a procedure provided for in the EU treaties. Some of the offending provisions of Ireland's corporate-tax regime were amended in the 2015 budget, but the government has reiterated its commitment to maintaining a low corporate-profit tax rate.

Citation:
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In this document 2.1% growth in GDP was forecast for 2014.
In The 2015 budget, published six months later, this forecast had been revised up to 4.7%.
The latest review of Ireland's economic prospects issued by the Department of Finance is available here:
http://www.finance.gov.ie/sites/default/files/Presentation%20to%20FINPER%20Committee%207%20October%202014.pdf

Israel

Score 7

Like other countries, the Israeli economy was affected by the world economic crisis. Nonetheless, it achieved a growth rate of more than 3% in 2010, higher than that of most industrialized countries. During 2014, the annual growth rate was around 2.5% and the inflation rate remained low at 0.5%. A general employment rate of 79.3% indicated a minor but constant improvement. The Israeli deficit is still a cause of concern. Although Israel's fiscal stability was a key factor in its ability to withstand the global financial crisis, during the past four years it has suffered from a high deficit of above 3%. Due to the recent "Protective Edge" military operation in the Gaza strip and the minister of finance's refusal to increase taxes, the budget for 2015 is expected to include a deficit of 3.4%, higher than the 2.5% that is stipulated by law.

A policy paper issued by the Taub Center in 2012 differentiates between structural and cyclical/temporary economic difficulties in Israel in order to examine the economy’s efficiency outside the influence of short-term disturbances. This enables to review Israel’s overall policy pattern instead of looking at short-term solutions to external or geopolitical pressures. Overall, Israel dealt well with the global crisis and the various related economic challenges. However, it does show structural problems with respect to core issues such as government spending, housing, health and education. These were vocalized by the middle-class during the demonstration of 2011 – 2012, and were key issues in the 2013 elections. A 2011 report prepared by Israel’s central bank identified financial-market centralization and a continuous amplification of risk as prominent problems. The government responded by reducing the risk that banks are allowed to carry for large borrowers. In 2014, the central bank issued a favorable evaluation of risk management in the bank and insurance sectors, while endorsing further cooperation between regulators.

Like many countries engaging in privatization, Israel is adapting its regulatory mechanisms. Research on water and power services shows an unorganized and inefficient regulatory system with some conflicts of interests. In general, while Israel’s economic policy has its shortcomings, it largely does provide for a reliable economic environment and supports the objectives of fostering the country’s competitive capabilities and preserving attractiveness as a location for economic activity.

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Luxembourg

Score 7

Luxembourg has been ranked highly on international competitiveness indices. In the Global Competitiveness Report 2014 – 2015, Luxembourg jumped to position 19 out of 144 countries, a rise of three places compared to the previous year. However, some indicators have been less well evaluated. The World Economic Forum awarded Luxembourg a poor rating both the “restrictive labor regulations” and “inadequately educated workforce” categories.

Following a deterioration in competitiveness in 2013 as ranked by the International Institute for Management Development’s index, Luxembourg regained its 2011 level during the period under review here (rising from 13th place in 2013 to 11th place in 2014). The country scored positively with regard to policy stability and predictability, a competitive tax regime, a skilled labor force, a predictable legal framework and a business-friendly environment. However, the policy mandating the automatic exchange of information on capital income (FATCA) will be implemented in January 2015, and is expected to impact the financial sector, which provides a third of Luxembourg’s GDP. The European Union has also modified its VAT regime for electronic commerce to the detriment of Luxembourg, which is home to many e-commerce companies because of its favorable tax rates. This will lead to a loss of tax revenue in 2015 (although following negotiations with the EU Commission, this policy will be implemented incrementally through 2018), obliging the government to increase its general VAT rates. New hubs and clusters have been created in an effort to create new revenue sources as the financial sector’s power diminishes. The Luxembourg Cluster Initiative is focused on high-priority sectors for the Luxembourg economy, including life sciences, eco-technology, information and communication technology, materials and production technologies, space technology, logistics and maritime activities.

To grow, Luxembourg needs to expand its labor force with highly skilled workers. According to employers’ organizations, the government needs to focus on accelerating the pace of administrative work and procedures, as well on reforming the automatic salary index mechanism, which raises wages automatically according to inflation rates.

The country’s generous welfare model has to be reformed to adapt to a reality of more modest public resources and budgets. In its evaluation of Luxembourg’s Stability Program 2012 – 2015, the European Commission agreed with this macroeconomic scenario, it also highlighted concerns over the country’s overly optimistic economic-growth outlook and its inability to address early retirement and pension reform.

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Netherlands

Score 7

Economic policy shows an intriguing paradox. On the one hand, the overall state of the economy remains unambiguously negative: in 2013 the real economy decreased by -0.7%; consumption of households (furniture, cars) and business investments (especially in construction) also decreased; inflation was stable at 2-5%. This was partially offset by a (slower) growth of external trade. Unemployment increased from 6.4% in 2012 to 8.3% in 2013. Austerity measures by the government are imitated by households that spend less and less money on consumption, but, for instance, increase the amount they pay off on mortgages and other debts.

On the other hand, the comparative international situation of the Dutch economy still looks fine. In terms of GDP per capita in 2013, the Netherlands ranks 10th among OECD countries and 5th of the euro zone countries. In the OECD's Foreign Direct Investment Restrictiveness Index for 2013, the Netherlands ranks 6th behind a.o. Switzerland, the US, Finland, and Germany; but before the UK, Sweden, Norway and Denmark. In the World Economic Forum's Global Competitiveness Report 2014 the Netherlands slightly increased its ranking from 9th in 2009 to 8th in 2014. The World Economic Forum has criticized practices in hiring/firing, wage determination, the housing bubble and access to credit.

In sum, although the Netherlands is caught in a long-term slump, prospects for recovery look bright. A very different interpretation of the same state of affairs suggests that in spite of having followed neoliberal economic principles, traditional cycles of economic growth and recovery are no longer par for the course. As a result, the Scientific Council for Government Policy (WRR, 2013) has urged the government to rethink the Dutch economic structure by investing in future earning capacity so as to expedite innovatiaon and make the economy more resilient in terms of labor productivity and transnational value chains.

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South Korea

Score 7

According to OECD data, South Korea showed one of the OECD group's strongest recoveries from the 2008 global recession. In the face of the global downturn since 2012, sluggish domestic demand, increasing household debt and a decline in job growth South Korea's recovery has lost momentum. During 2013 Park Geun-hye's first economic team sought to boost domestic demand through an extra budget worth 17.3 trillion won (.4 billion) and property market stimulus measures. Yet, despite the good performance of exports, the expansionary fiscal policy did not stimulate consumption and investment sufficiently to drive economic growth and revitalize the domestic economy. Sluggish economic growth raised concerns that South Korea's economy could fall into a long-term slump, similar to that in Japan.

In the second year of her presidency, Park abandoned her "economic democratization" agenda and switched to an agenda of economic revitalization. On the first anniversary of her inauguration in February 2014 she unveiled a Three Year Plan for Economic Innovation with an ambitious "474" vision, targetting– a 4% GDP growth rate, 70% employment rate and a per capita income of $40,000. Her second economic team led by the Finance Minister Choi Kyung-hwan appointed in July 2014 has announced a $40 billion stimulus package and put pressure on the Bank of South Korea to adjust its monetary stance in harmony with the pro-growth fiscal policy. Bowing to government pressure, the Bank of South Korea pulled back from its hawkish policy stance and, in August 2014, cut the targeted interest rate for the first time in 15 months. While this rate move by the central bank raised questions about its independence, the rate cut was welcomed by the Park administration as a necessary step towards reviving the housing market. A further rate cut followed in October 2014. At the same time, Park's administration pushed ahead with housing market deregulation measures including the relaxation of loan-to-value and debt-to-income ratios. Yet, critics warned that the aggressive policies to prop up an anemic housing market could exacerbate the country's heavy household debt burden.

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Czech Republic

Score 6

Czech economic policy has been based on the single overriding objective of reducing the state budget deficit and thereby limiting the growth in public debt. Both were low by European standards, but the policy mix and severity of austerity measures were similar to those in euro zone member states facing severe debt crises. This policy is not linked to an aim of early accession to the euro which might be hoped to lead to greater stability than the maintenance of an independent currency. No timetable has been set for this accession, although President Zeman and the Czech Social Democratic Party (ČSSD), the biggest government party, have distanced themselves from past euroskeptic policies and have speculated over possible early accession dates. The recession of Czech economy however continued in 2013. The Czech economy, heavily export-oriented, is dependent on development in other EU countries and on inward investment to develop export sectors. A key sector has been automobiles, yet depressed demand in Western Europe has contributed to reducing investment levels. The Central Bank has intervened in foreign exchange markets to devalue the currency. This has resulted in an increase in import prices, but makes little difference to exports which compete more on quality than on price. Overall, these strategies do not represent a basis for long-term growth. Restricting public spending has had the effect of stalling construction projects, including those for infrastructure, housing and social facilities, and squeezing potential investment in research, education and innovation, without which sustainable growth levels will be difficult to achieve. The immediate prospects are for only a gradual economic recovery, tied to the fortunes of larger euro zone countries.

Iceland

Score 6

Iceland’s economic policy continues to be dominated by the fallout from the 2008 economic collapse. The IMF program, launched after the 2008 economic collapse, imposed strict capital controls, to prevent the króna from further depreciating, and a fiscal adjustment process, equivalent to about 10% of GDP, for the period 2010 to 2015. The promised gradual relaxation of the capital controls continues to be postponed, despite announcements to do so by the new government.

Following the 2008 economic collapse, the government sought to strengthen the heavily criticized Financial Supervisory Authority (Fjármálaeftirlitið). The number of Financial Supervisory Authority personnel was increased from 63 in 2008 to 93 in 2010 and to 117 in 2012. However, since 2012, the Financial Supervisory Authority’s annual budget has been halved for two consecutive years.

The future of Iceland’s banking sector remains uncertain, as the government has not presented plans for restructuring and reorganizing of the system. At the time of writing, the government owned a majority stake in one of Iceland’s three largest banks. Meanwhile, foreign venture funds own significant stakes in the other two banks, a temporary situation. Iceland is one of very few countries in the world without any foreign competition in its local banking scene.

Iceland applied for EU membership in 2009. The previous government had signaled its intention to abide by EU standards and discipline, and to strengthen Iceland's institutional environment, including its regulatory policy. However, due to disagreements between the previous government's coalition partners, the application process was put on hold in January 2013. After April 2013's parliamentary elections, the new government withdrew from negotiations with the EU and expressed its intention to unilaterally retract Iceland's membership application. Yet, due to substantial public protests, the negotiations remain on hold rather than completely abandoned. The new government continues to threaten a formal withdrawal which would require any future process to once again secure the approval of 28 of the EU's member states.

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Italy

Score 6

As a result of the shifting political landscape since 2013 and some political instability – including the succession of two cabinets (Letta and Renzi) in the space of one year from 2013 to 2014 and the Forza Italia's shifting support, some key features of economic policy have been subject to changes during the period under review. Whereas the Letta cabinet focused on stabilizing the budgetary situation (in order to comply with European targets) and gradually developing measures promoting economic recovery (which initially seemed more promising), its successor, the Renzi government, has been more likely to accelerate expansionary measures, which have become even more urgent as economic growth failed to materialize. Prime MInister Renzi's government has been the first to clearly identify Italian society's main economic challenges and respond with a set of significant reform projects. The government has, for example, introduced income allowances for lower incomes (e.g., in the form of a monthly €80 transfer payment), tax reductions for businesses (IRAP reduction), plus a new ambitious labor law reform aimed at stimulating the economy. The budget proposed for 2015 takes further steps in this direction and has increased the IRAP reduction, lowered the costs of hiring young workers, and cut state and local authorities' expenditures. Whether these policies will prove effective is too early to say, but they seem to be a step in the right direction.

Mexico

Score 6

On the positive side, the general quality of macroeconomic management in Mexico is good. The Finance Ministry and the central bank (Banco de México) benefit from a considerable wealth of technical expertise. Such economic stability in recent years represents a real achievement given the frequency with which Mexico faced economic crises in the 1980s and 1990s. As a result, the Mexican economy has been able to keep growing despite the recent global economic downturn and current financial difficulties. Microeconomically, the picture is less clear, though it has some positive features. Mexico is an export economy tied to the North American market. Its economy can cope for the most part with competition from China, which a few years ago seemed to pose a real threat. Indeed, exports are by and large doing well. The country has economic problems based on a lack of internal economic competition in key sectors such as telecommunications, with a tendency to generate oligarchies. However, the current Mexican government has made it a priority to increase domestic competition, and has enacted some significant reforms in this area. It remains to be seen how they will function in practice. Unfortunately, organized crime and the related legal insecurity have acted as barriers to investment in the regions most affected, and have also contributed to a migration-driven brain drain in these regions. Moreover, illegal money laundering from drug-related activities has channeled huge financial resources into the formal economy, blurring the border between illegal and legal economic activities.

New Zealand

Score 6

New Zealand is widely known for its significant structural policy reforms introduced in the 1980s and 1990s. Despite early opposition, these reforms have had a largely positive impact, and the resulting policy settings have remained largely intact. Yet New Zealand is also often cited as a country for which free-market reforms have not yielded the improvements in productivity, economic growth and living standards that were anticipated and promised by reformers. Advocates of yet further policy reform hold the previous Labour Party-led government (1999 – 2008) and the present highly pragmatic and moderate National-led government (2008-) responsible for an alleged lack of progress. Particular concerns have been directed toward the design and objectives of some of the new regulations, while other explanations for poorer-than-expected growth focus more on New Zealand’s small size and remoteness, as well as its skill shortages, on the labor market.

As indicated, although the demand for a return to growth became more insistent after the National Party-led government took office in 2008, substantive policy change since then has been relatively modest. Some have blamed the minority nature of the National-led government for the slow and incremental nature of change. However, given that National has been able to implement a vast majority of its economic initiatives, responsibility may have less to do with its compliant junior partners than with the cautious, pragmatic and poll-driven nature of the government's economic agenda under the leadership of Prime Minister John Key. This is not to ignore the wider context of the world financial crisis, which drove the New Zealand economy into recession, albeit less severely than in many other Organization for Economic Cooperation and Development (OECD) countries. Fiscal surpluses, due in part to earlier reforms, swung to deficits. Getting back to a balanced budget has since been the pre-eminent issue on the government's agenda. After a period of slow growth, real GDP growth is currently driven mainly by post-earthquake rebuilding, a strong increase in immigration, and favorable terms of trade. The inflation rate modestly rose to 2% in 2014. By then it had become clear that the government's planned surplus in 2014-15 would be delayed by at least a year.

Citation:
Government at a Glance – Country Note: New Zealand (Paris: OECD 2013).
OECD Economic Outlook No. 95 (Paris: OECD 2014).
OECD Economic Surveys – New Zealand (Paris: OECD 2013).

Portugal

Score 6

Portugal's bailout by the so-called Troika of the European Union (EU), the International Monetary Fund (IMF) and the European Central Bank (ECB) was formally completed on 17 May 2014. The period analyzed here thus encompasses both the final year of the three-year bailout program initiated in May 2011, and the first six months of the post-bailout period.

The Memorandum of Understanding (MoU) signed with the Troika at the time of the 2011 bailout had three objectives: first, fiscal consolidation; second, stability in the financial market; and third, most relevant to the question at hand, to "boost potential growth, create jobs, and improve competitiveness" (European Commission, "The Economic Adjustment Program for Portugal 2011-2014").

This third goal derived from the Portuguese economy's anemic growth trajectory since the new millennium, featuring both low GDP growth and low productivity growth (European Commission, "The Economic Adjustment Program for Portugal 2011 –2014," p. 3).

To achieve these goals, the MoU foresaw "deep and frontloaded structural" reforms (European Commission, "The Economic Adjustment Program for Portugal 2011-2014," p. 3).

It is unquestionable that the government implemented several reforms aimed at improving Portugal's economic competitiveness over the period of the MoU's implementation. It is equally important to note that the issues of international competitiveness and export promotion moved to center stage in Portuguese economic discourse and policy during the MoU period. These broader patterns are also evident during the period under analysis here, and did not abate with the end of the bailout period.

However, the pattern of economic-policy changes in the recent period – which continued in the period here under analysis – has also made the policy framework less stable. The pressure to continue these reforms remains strong, with the European Commission noting that market rigidities remain, and that “significant scope for additional reforms remains in key areas” (European Commission, “The Economic Adjustment Program for Portugal 2011-2014,” p. 5).

Moreover, the focus on reducing the budget deficit has also inevitably impacted on economic policy. The austerity measures have percolated through to produce an economic recession that continued through 2013, although the economy began to show positive growth in 2014.

Portugal’s international competitiveness remains largely unchanged vis-à-vis the previous report. The country retained a positive trade balance in 2013 and in the first period of 2014. However, the mild economic recovery seen in 2014 also translated into a rise in imports, meaning that the positive trade balance is smaller in 2014 than seen in 2013.

Citation:
Memorandum of Understanding (MoU) between Portugal and the EU, IMF, and European Central Bank.

European Commission, “The Economic Adjustment Program for Portugal 2011-2014.” Available online at: http://ec.europa.eu/economy_finance/publications/occasional_paper/2014/pdf/ocp202_en.pdf

Slovakia

Score 6

The Slovak economy recovered quickly from the recent recession, and in 2013 and 2014 showed one of the highest growth rates in the OECD and the European Union. Economic growth is predicted to increase further in 2015, although the growth rate remains under the pre-2009 level. The return to economic growth has been facilitated by improvements in the international economic environment. Moreover, the Fico government’s initial focus on fiscal consolidation helped attract foreign investment by strengthening Slovakia’s image as a reliable and trustworthy member of the euro zone. While the Fico government has been careful to avoid reversing too many of the liberal reforms of the past, it has failed to make economic growth sustainable by promoting research and innovation, or by improving education, family and migration policies.

Spain

Score 6

Beginning in 2008 and ending in 2013, Spain sunk into a deep double-dip recession that lasted five years. This terrible period, in which unemployment exceeded 25% and the country had the highest public deficit among EU countries (see “Labor Markets,” “Taxes” and “Budgets”), exposed serious internal structural weaknesses linked to a real estate bubble and massive losses of productivity since 2000. As a member of the euro zone, has grappled with a very difficult situation in which it has lacked flexibility in its monetary and exchange rate policies and has been subject to strict fiscal austerity. Moreover, the flaws in the design of the euro seriously damaged the functioning of the euro zone interbank system, making it difficult for Spanish institutions to refinance their debts. With sovereign risk at unsustainably high levels, social unrest on the rise, and growing doubts about the banking system, it was not surprising that, after Greece, Spain became a subject of considerable international concern.

However, since 2013, Spain has been undergoing a surprisingly strong recovery as the economy has adjusted quickly. Spending cuts and some structural reforms as part of the government’s National Reform Programme (labor market, control of public finances, banking sector recapitalization) proceeded at a rapid pace, unit labor costs fell significantly and productivity rose. Most encouragingly and despite the strength of the euro, exports began booming already in 2011 and, after 2012, FDI increased as well. Once Spain’s access to finance was expanded (a result of ECB policies) and granted by the European Commission more flexibility in meeting its fiscal targets, the economy began to grow again. Spain’s recovery gathered momentum in 2014 with the economy growing by 1.4%, the highest level in more than six years (estimates for 2015 suggest an impressive 2.5% in growth, which is much higher than that seen in other large euro zone economies). This recovery combines net exports and, for the first time in several years, domestic demand. However, it remains premature to assume that a truly sustainable economic path has taken hold, as bank lending remains limited, inequalities are growing and unemployment is high (24% in autumn 2014).

Citation:

Charles Powell and Federico Steinberg. “The Pain in Spain: Light at the End of the Tunnel?”, The International Spectator: Italian Journal of International Affairs (Volume 47, Issue 4, 2012).

The Economist. 2014. “Bouncing back”. www.economist.com/news/europe/21605962-surprisingly-strong-recovery-largely-export-driven-bouncing-back

Bulgaria

Score 5

Since the late 1990s, Bulgarian economic policy has been characterized by a discrepancy between macro- and microeconomic policy. Whereas the country’s macroeconomic policies – most notably the monetary regime, a currency board arrangement tied to the euro – have been generally effective, microeconomic policies have been less successful. Investors complain about regulation and red tape; in many sectors of the economy, competition is limited; labor-market policy creates disincentives to work or create jobs; and subsequent governments, with their emphasis on creating a low-tax and low-wage economy, have done little to increase skill levels, foster innovation or raise productivity. Like its predecessors, the Oresharski government failed to address these microeconomic problems. By softening fiscal policy, it also raised concerns about macroeconomic policy.

Japan

Score value_6

The LDP-led government, which took office in December 2012, embarked on a so-called "three arrows" strategy, consisting of aggressive monetary easing, a highly ambitious deficit-financed spending program (despite record levels of public debt), and a program of structural reforms. In the short term, the first two arrows led to a surge of optimism in the economy, although their unorthodoxy entails grave hazards that would have been deemed irresponsible even a year before. According to The World Bank, Japan's economy grew 1.6% in 2013. A strong devaluation of the yen in response to the monetary easing played a considerable role. Corporate profits and share prices also rose significantly. Another positive sign was that deflation was overcome, for the time being.

Much less transpired with respect to the promised structural reforms (the "third arrow") – such as adjusting the labor market or insolvency procedures, strengthening the role of women in the labor market, or concluding a Trans-Pacific Partnership (TPP) agreement with the United States and other countries, which in turn requires liberalizing Japan's agricultural market. While the government led by Shinzo Abe announced various structural reform measures in 2013 and 2014, many observers remain underwhelmed (for an influential critique, see Katz 2014). With an increase of the value-added tax (VAT) in April 2014 and a return of (low) inflation, household incomes have suffered, especially as base wages kept declining. Consequently, consumption has remained flat, with a stronger than expected negative reaction to the VAT hike. Private investment has also not taken off, hampered by a less than expected reaction of the export markets to the devaluation. Moreover, amidst high profits, retained earnings continued to rise, reaching about 60% of GDP at the end of 2013.

In late October 2014, in the face of an again weakening economy which began in the second quarter of 2014 (and which would led to a veritable recession later in the year), the Bank of Japan announced a further strong monetary stimulus, including raising its target for annual asset purchases - mainly government bonds - to ¥80 trillion (about $700) from the previous target range of ¥60 trillion to ¥70 trillion. Opinions on the policy are extremely divided; the policy board deciding by a vote of only 5:4. Some observers see it as a "desperate move", with the BOJ printing ever more money to effectively finance fiscal deficits. A much more sustainable solution consists of implementing thorough reform measures, which more and more observers consider unlikely under an Abe-led government.

Citation:
Richard Katz, Voodoo Abenomics. Japan’s Failed Comeback Plan, in: Foreign Affairs, July/August 2014

Jonathan Soble, Off target, Financial Times, 26.08.2014, p.7

Japan Times, Wealth gap widening under Abe, 23.11.2014, p. 2

Romania

Score 5

Economic policy in 2014 was affected by the decision of the center-right National Liberal Party (PNL) to leave the governing coalition, as well as by the electoral campaign for the November 2014 presidential elections. As expected, Prime Minister Victor Ponta’s new government engaged in a number of populist measures meant to improve Ponta’s prospects of winning the presidential elections. However, these populist tendencies were kept in check by the economic slowdown that materialized in the first part of 2014, and by the policy constraints imposed by the new two-year standby agreement signed by the government and the International Monetary Fund in September 2013.

Future growth prospects will depend on the government’s ability to improve governance in crucial areas, thus attracting more foreign investment and improving the country’s ability to absorb EU funds. Although absorption rates increased from 17% in mid-2013 to almost 35% in late 2013, they were still below the government’s 50% target by late 2014, and remained well below the regional average. While the electoral victory of Iohannis, who campaigned on the promise to reduce corruption and the state’s role in the economy, may provide an impetus for progress, the potential for power struggles between President Iohannis and Prime Minister Ponta, as well as the prospect of early parliamentary elections, could lead to political instability and undermine the adoption of necessary economic and governance reforms.

Citation:
Romanian Academic Society 2014 annual report, www.sar.org.ro
Economist Intelligence Unit 2014, Country Report - Romania, www.eiu.com

Slovenia

Score 5

In the period under review, Slovenia struggled to overcome a protracted economic crisis that was compounded by rising public debt, high unemployment rates and a problematic banking sector. Especially during the first half of 2013, credit ratings assigned to the country by the top rating agencies dropped significantly, pushing Slovenia to the brink of a full-blown debt crisis. While overall reforms remained modest, the Bratušek government ultimately succeeded in averting the crisis, and Slovenia was not forced to draw on EU bailout funds. In the second half of 2014, the economy returned to a condition of positive growth. The recovery appears broad-based, with both external and domestic improvements. Net exports have remained resilient and investment has risen, largely due to EU-funded projects.

Turkey

Score 5

Over the past decade, Turkey has experienced important gains in income and living standards. Recently, it has also improved its competitiveness. The country is relatively well positioned in global competitiveness rankings, ranking 46th in the World Economic Forum's 2014 – 2015 Global Competitiveness Index, and improving its position in the World Bank's Doing Business ranking from 71st in 2013 to 69th in 2014. The contributions of the 1995 EU-Turkey customs union, the EU accession process, and the global economic boom through 2008 have played a considerable role in these achievements,

After rising 8.8% in 2011 and 2.1% in 2012, Turkey's GDP rose 4% in 2013 to $820 billion. The country's slowdown since 2012 has been partly due to the ongoing global financial crisis, and partly to Turkish policymakers' desire to slow the economy in order to bring current account deficits under control. Moreover, regional Turkish export markets such as Syria and Iraq, which had boomed in the past, were themselves suffering from setbacks due to political instability and war.

On the inflation front, the consumer price index increased from 6.5% in 2011 to 8.9% in 2012, but decreased again to 7.5% in 2013. As of June 2014, the annual inflation rate had increased to 9.16%. Thus, headline inflation rate remains well above the Central Bank target of 5%. On the other hand, the hourly-labor-cost index increased by 9% in 2011, by 10.5% in 2012, and 12.7% in 2013. According the most recent figures as of the time of writing, the hourly-labor-cost index increased by 12% on a year-over-year basis during the first quarter of 2014. The banking sector has proved resilient in the face of global financial crisis thanks to robust capital buffers and a healthy loan portfolio. The government's overall fiscal performance was satisfactory.

Turkey's most significant problems are related to external imbalances. The current-account deficit declined from $75.1 billion in 2011 (9.7% of GDP) to $48.5 billion in 2012 (6.2% of GDP). In 2013, the current-account deficit amounted to $65.1 billion, or 7.9% of GDP. While the annualized current-account deficit at the end of the first quarter of 2014 amounted to $60.2 billion, the annualized deficit declined to $40.5 billion at the end of that year's second quarter. However, this amount is still considerable. Financing composition has changed over time, with net foreign direct investment constituting 18.4% of the current-account deficit in 2011, and 18.9% in 2012. This share fell to 15.1% in 2013.

Turkey's net international-investment position (NIIP), defined as the value of total external assets owned by Turkish residents in the rest of the world minus the value of total external liabilities of Turkish residents to the rest of the world, decreased from -4.3 billion at the end of 2011 to -2.4 billion in 2012; this rose to -3.7 billion at the end of 2013, but had again declined to -8.2 billion by the end of July 2014. The country's net foreign debt at the end of July 2014 thus amounted to $438.2 billion. Considering the July 2014 figures for net foreign debt and the IMF's estimate of GDP for 2014, the net-foreign-debt-to-GDP ratio for 2014 would be 53.9%. Note that the change in a country's NIIP over time is determined largely by its current-account balance as a share of GDP. Thus, if Turkey's current-account-deficit-to-GDP ratio were to remain at 6%, and real GDP were to increase at its historical average annual growth rate of 5%, then the country's net-foreign debt-to-GDP ratio would increase over the long term to 126%, which is unsustainable. Turkey must therefore reduce its current-account deficit to sustainable levels. Since one of the main determinants of the current-account-deficit-to-GDP ratio is the real exchange rate, achieving sustainability with regard to the country's current-account deficit will require that the real exchange rate be depreciated over time.

The law on state aid and subsidies adopted in October 2010 remained unimplemented as of the time of writing. An omnibus law postponed the entry into force of legislation implementing the State Aid Law until the end of 2014. As of the time of writing, the State Aid Authority had not yet formally established a comprehensive inventory of state-aid measures. Nor had it adopted an action plan for aligning all state-aid schemes with the EU acquis, including the incentives package passed in 2012. On the other hand, a new Electricity Market Law was enacted in March 2013 with the aim of introducing more competition into the market and improving alignment with the EU Electricity Directive. Following the law's enactment, an estimated 85% of the market has been opened to competition, with the aim of achieving 100% by 2015. The transfer of distribution assets to private companies was completed, but progress in the privatization of electricity-generating assets remains rather limited. Separately, amendments to public-procurement legislation have brought the country further out of line with the EU acquis. The February 2014 omnibus law made the previously optional domestic price advantage of up to 15% compulsory for "medium and high-technology industrial products." The amendment also introduced an offset option in public tenders and exempted acquisitions involving offsets from the Public Procurement Law, thereby contradicting the EU acquis.

Citation:
European Commission, Turkey Progress Report, October 2014, http://ec.europa.eu/enlargement/pdf/key_documents/2014/20141008-turkey-progress- report_en.pdf (accessed 5 November 2014)
World Bank (2014) World Bank Group - Turkey Partnership: Country Program Snapshot, Washington D.C.: The World Bank (April).
AK Party, 'Turkey reveals new reform plan to boost economy', 6 November 2014, https://www.akparti.org.tr/english/haberler/turkey-reveals-new-economic-plan-to-boost-economy/68377#1 (accessed 5 December 2014)

Australia

Score 4

Australia’s economy grew remarkably in the 1990s and 2000s, but economic growth, and the outlook for economic growth, has deteriorated markedly since 2012. The unemployment rate has slowly but steadily risen over the review period, increasing from 5.6% in May 2013 to 6.2% in October 2014. Australia remains highly dependent on the export of natural resources, and commodity prices continue to decline. Prices for iron ore, Australia’s biggest export product, have been hit hard by the declining demand for steel in China. Taxation revenue has correspondingly declined as a share of GDP, resulting in a succession of substantial budget deficits since 2009. In contrast to other natural resource-dependent economies, such as Norway, Australia has not created a future fund to cushion the impact of a downturn in commodity prices. A lack of microeconomic and tax reforms over the last decade has also contributed to the recent slowdown in economic and employment growth.

Following a change in government in September 2013, significant economic policy changes over the review period included the removal of the carbon tax in July 2014 and the Minerals Resource Rent Tax in September 2014, the deferral of planned increases in the minimum contribution rate for employee superannuation (private pensions) to 2021, and a temporary (2-year) increase in the top marginal income tax rate beginning July 2014.

The main barrier to an integrated economic policy continues to be the federal structure of government, and the duplication of many services and regulatory functions between the federal government and the governments of the six states and two territories. The federal system of government has, for example, proved to be a particular barrier in achieving effective management of water resources, and federalism has also proved to be a barrier in achieving cooperation across the jurisdictions. As a result, reform of many social services, most notably health and education, has reached an impasse. The core of the problem is the lack of any revenue-raising powers among the states, which are dependent on block grants from the federal government. The Labor government had some success in addressing this problem, signing health funding agreements with all jurisdictions other than Western Australia in 2011 and reaching agreement on reforms to education funding with five of the eight states and territories in 2013. However, the Liberal-National coalition government elected in September 2013 has not committed to these agreements beyond their initial term and indeed has announced it will only honor the first 4 years of the 6-year “Better Schools” funding agreement.

Citation:
http://www.theguardian.com/business/grogonomics/2014/oct/28/miners-iron-ore-prices-colin-barnett

http://www.smh.com.au/national/iron-ore-downturn-puts-wa-in-the-doldrums-20141205-12165u.html

Cyprus

Score 4

Cyprus has applied an economic model that until 2011 ensured sustained growth. Founded on a market-oriented economic system and macroeconomic policies, this model enabled the country to overcome the socioeconomic disaster associated with the Turkish army invasion of 1974. A dynamic, flexible, entrepreneurial-minded and highly educated labor force, as well as collective-bargaining procedures between businesses and trade unions that secured labor-market stability, contributed to its success. Additional factors attracted a large number of foreign firms to Cyprus' shores, included an advanced technological infrastructure, advanced legal and accountancy-support services, the taxation system and double-taxation agreements, and efficient telecommunications networks. Cyprus' geographic location and EU accession in 2004 offered additional advantages as a business center.

However, the above-noted policies ultimately relied too heavily on sectors affected by seasonality, unproductive investments and increasing labor costs that were not matched by productivity gains. Criticism of an oversized offshore sector and recommendations to implement structural reforms and balance the country's public finances were ignored. The already vulnerable economy was critically affected by the overexposure of Cyprus' two major banks to Greek debt, which compromised their viability and increased the state's borrowing costs. When Cyprus was ultimately cut off from international money markets (May 2011), the government's response was slow and inadequate. It sought the European Stability Mechanism's (ESM) assistance in July 2012, but an agreement was signed only nine months later by a newly elected government.

Severe credit constraints still in effect as of the time of writing in practice relegated Cyprus to the margins of the euro zone, while gravely affecting market activities. New policies have aimed at implementing extensive reforms as required by the MoU with Cyprus' creditors. However, if it is to regain a path of sustainability, the government must also address problems associated with the implementation of the MoU and reestablish confidence in the system. A downsized financial sector is emerging characterized by stricter rules and enforcement mechanisms, along with measures to ensure the viability of a banking sector damaged by the bail-in and a major bank closure.

Strict conformity to the MoU has resulted in lower-than-forecast deficits and a milder recession than expected. Modest growth was expected for 2015. However, major challenges lie ahead, including the implementation of non-performing-loan regulations, further changes in fiscal policy, the restructuring and privatization of semi-governmental organizations, and lowering unemployment rates.

Reaching a new social consensus remains a crucial factor for success. However, social actors and political forces have been called upon to support important measures and policies that have been decided without their involvement.

Citation:
1. EU assessment of the reform program, 2014, http://ec.europa.eu/europe2020/pdf/csr2014/swd2014_cyprus_en.pdf
2. European Economic Forecast on Cyprus, 4 November 2014,

http://ec.europa.eu/economy_finance/eu/forecasts/2014_autumn/cy_en.pdf

France

Score 4

France faces a bleak economic outlook. Structural problems, such as a rigid labor market, high unemployment, growing public debt, insufficient funding of social security systems, an unfriendly entrepreneurial environment and a lack of competitiveness, are ingrained and acute. These are factors that limit the growth potential considerably. The French growth model has been based on domestic demand, fuelled by state subsidies, budget deficits and public debt. All these problems however are well-known and have been assessed in multiple reports over the years. The call is unanimous for supply-side reforms to increase the growth potential of the French economy.

The Sarkozy government (2007 – 2012), despite reforms and the president's activism, did not really meet the challenge. The Hollande government (since May 2012) initially did not correctly assess the seriousness of the situation and was thus ill-prepared to address the problems both in terms of strategy and sectoral measures. Faced with a rapidly deteriorating situation, President Hollande has announced measures which, in sum, represent a reform agenda, but which have not been presented as such. Moreover, no major reform has yet been adopted except for savings in the budget and reductions of taxes and levies on companies in order to restore their competitiveness somewhat. None of the announced targets has been met: growth is flat, the budget deficit is still well above the requested 3% of GDP, public debt is growing and is more than 2000 billion euros (97% of GDP), while unempoyment is above 10%.

Hopes of economic growth that would, in turn, allow the Hollande government to make changes more acceptable to a reluctant public did not materialize. Instead, the government must grapple with poor growth, which makes the adoption of reforms and budget consolidation politically more difficult. At the same time, the lack of reforms further limits France's growth potential. Thus, the Hollande government, like its predecessors, has turned to "stealth reforms" in an attempt to appease its electoral and party base. But the reforms adopted thus far are not commensurate with the enormous problems the country is facing.

Greece

Score 4

Greece ran a budget deficit for each year from 2003 to 2012, but achieved in 2013 a surplus. Fiscal consolidation was brought about through austerity measures which included successive cuts in wages, salaries and pensions and increases in income and wealth taxes. The latter were particularly felt by all social groups in 2014 when the government implemented a new integrated tax on landed property (the ENFIA tax). The goal in imposing this tax was to broaden the tax base in a country in which undeclared income had for years been channeled into construction projects or purchased land assets.

However, the combined effects of wage, salary and pension cuts with increased taxes has had an ongoing negative impact on economic growth. A six-year recession has taken its toll on the productive base of the economy.The single exception to this being tourism, which thrived in 2014. Estimates suggest that in 2014, 21 million tourists visited Greece (pop. 11 million). Still, as GDP shrank by about 25% over from 2008 to 2013, public debt showed no improvement and Greece now has the highest unemployment rate in the EU.

The EU's bailout conditionality has been crucial to fiscal re-balancing. More problematic has been the slow and patchy progress of structural reforms, which point to a long-term systemic problem. In implementing bailout conditionality, the EU itself has been somewhat clumsy in this regard, pressing more often for immediate than considered measures. Bureaucratic inertia within Greece as well as resistance to the Troika on the part of professional associations that previously enjoyed closed access regimes have slowed progress, as has the lack of capital. Greek banks passed "stress tests" in the late autumn of 2014, but until then were reluctant to lend money to new business endeavors. Few new shops or businesses have been set up, with the exception of low-cost catering or tourist businesses (cafeterias, small restaurants, tourist shops).

In sum, the fiscal situation has been stabilized, but the economy has been revived only slightly. Unemployment remains at painfully high levels, creating fears of long-time permanent social dislocation for the long-term unemployed. Without targeted and additional funding from the European Union's cohesion funds and foreign direct investment (FDI) in tourism, agriculture, landed property and the state-owned enterprises undergoing privitization, it is unlikely that the economy will grow in the near future.

Citation:
Information on Gross Fixed Capital Formation and Ouptut Growth drawn on the SGI provided by this platform. Rest of data on macroeconomic indicators come from Eurostat. For example, on unemployment see http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Unemployment_statistics. On Greece's public debt, see http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&language=en&pcode=teina225. An on Greece's annual GDP growth in 2008-2013 (which negative for every single year in that period), see http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tec00115

Croatia

Score 3

Between May 2013 and November 2014, the economic situation in Croatia continued to deteriorate. The relaxation of fiscal policy in 2013 led to uncertainty over the government's course, and was poorly received by the leading rating agencies and other international observers. Optimistic predictions that the Croatian economy would recover in 2014 were not fulfilled, and indeed, a further decline in GDP was recorded for the year. The prospects for 2015 are little better. This means that Croatia may experience a sixth consecutive year of recession, a precedent of a sort in modern European history. The Milanović government has largely failed to address these problems. Only after Croatia was placed under the EU's excessive deficit procedure in January 2014 were some reforms eventually launched. However, the European Commission Alert Mechanism Report of November 2014 concluded that macroeconomic imbalances remain a serious concern, falling levels of investment are undermining economic recovery, export performance is weak, and Croatia is steadily losing its share of the global market. The report also noted that unit labor costs and the real effective exchange rate are starting to rise again, putting any gains made in improving competitiveness at risk.

Citation:
ECFIN (2014) "Macroeconomic Imbalances: Croatia 2014," European Economy Occasional Papers 179, March, Brussels: Directorate General for Economic and Financial Affairs
European Commission (2014) Alert Mechanism Report, Brussels

Hungary

Score 3

The second and third Orbán government have pursued a heterodox ("unorthodox," as the government calls it) and unpredictable economic policy that has been strongly criticized by the economic mainstream and by international organizations. Economic policy has been characterized by a growing state role, a strong rhetorical emphasis on the strengthening of national enterprises and the role of central bank on the one hand, and by a critical stance toward the International Monetary Fund (IMF), multinational companies and the banking sector on the other. As foreign investors have complained about additional burdens and unpredictable policy changes, FDI inflows have decreased. Following the end of recession in 2012, GDP growth picked up in 2013 and 2014. However, the unexpected surge in growth in 2014 was largely achieved through temporary measures such as a more efficient absorption of EU funds. Hungary's medium-term economic prospects look worse than is true of other countries in the region.

Citation:
HEBC, Hungarian European Business Council (2014) Annual Report: Sustainable and Inclusive Growth, Budapest, p. 82, http://www.hebc.hu/wp-content/uploads/2014/07/hebc_report_2014_Sustainable-and-inclusive-growth.pdf
IMF (2014) Statement at the Conclusion of the IMF's 2014 Article IV Consultation Mission to Hungary, Press

Release No. 14/115, March 20, 2014, http://www.imf.org/external/np/sec/pr/2014/pr14115.htm
Inotai, András, 2014: Ein Jahrzehnt ungarisches Mitgliedschaft in der Europäischen Union: eine kritische Bilanz, Integration 37(4): 320-344.
ECFIN Economic Brief, October 2014, http://ec.europa.eu/economy_finance/publications/economic_briefs/2014/pdf/eb37_en.pdf.

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